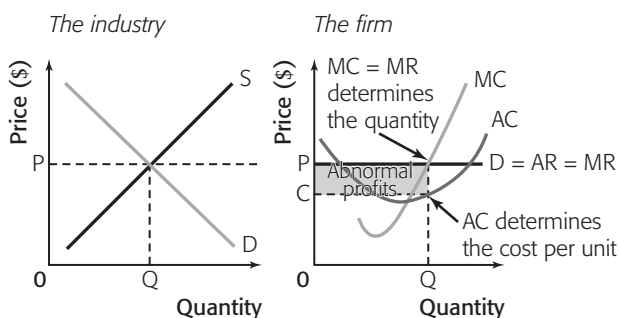


Perfect competition (PC) – assumptions

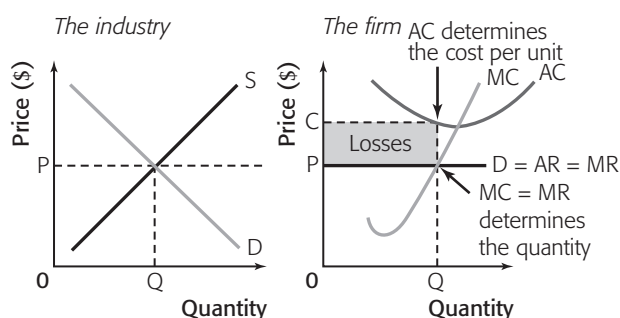
1. Industry is made up of a very large number of firms.
2. Each firm is so small, relative to the size of the industry, that it cannot noticeably affect the output of the industry as a whole. (Thus, the firms are price takers.)
3. The firms all produce identical goods, with no brand names and no marketing.
4. Firms are completely free to enter and exit the industry.
5. All consumers and producers have perfect knowledge of the market.

SHORT-RUN ABNORMAL PROFITS



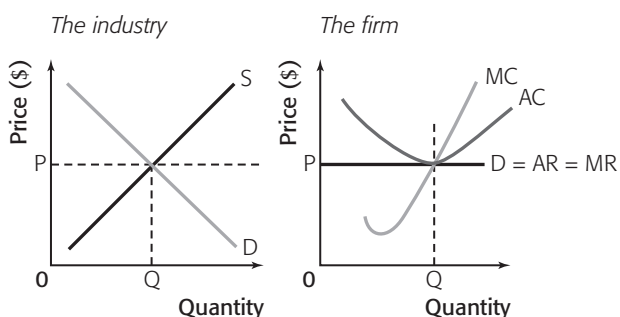
In PC, in the short run firms may make excess profits. If this is the case, other firms will start to enter the industry and eventually, the industry supply curve will shift to the right, prices will fall and firms will make normal profits in the long run.

SHORT-RUN LOSSES



In PC, in the short run firms may make losses. If this is the case, firms will start to leave the industry and eventually, the industry supply curve will shift to the left, prices will rise and remaining firms will make normal profits in the long run.

LONG-RUN NORMAL PROFITS



In PC, in the long run firms make normal profits.

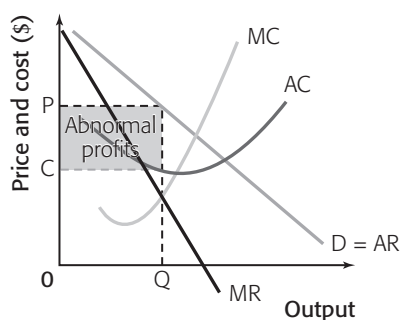
EFFICIENCY

In the short run in PC, firms are allocatively efficient, producing where $MC = AR$, but not productively efficient, because they do **not** produce where $MC = AC$.

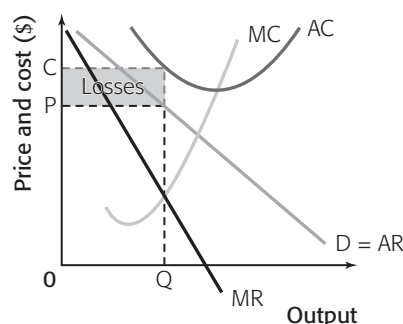
In the long run in PC, firms are allocatively efficient, producing where $MC = AR$ **and** productively efficient, producing where $MC = AC$.

Monopolistic competition – assumptions

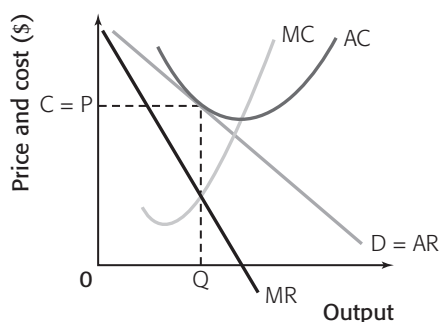
1. Industry is made up of a fairly large number of firms.
2. Each firm is small, relative to the size of the industry. The actions of one firm are unlikely to have a great effect on any of its competitors.
3. The firms all produce slightly differentiated goods.
4. Firms are completely free to enter and exit the industry.

SHORT-RUN ABNORMAL PROFITS

In monopolistic competition, in the short run firms may make excess profits. If this is the case, other firms will start to enter the industry, taking trade from the existing firms and competing away the abnormal profits. This continues until all firms are making normal profits in the long run.

SHORT-RUN LOSSES

In monopolistic competition, in the short run firms may make losses. If this is the case, firms will start to leave the industry and their customers are taken up by remaining firms, which find demand increases. This continues until all remaining firms are making normal profits in the long run.

LONG-RUN NORMAL PROFITS

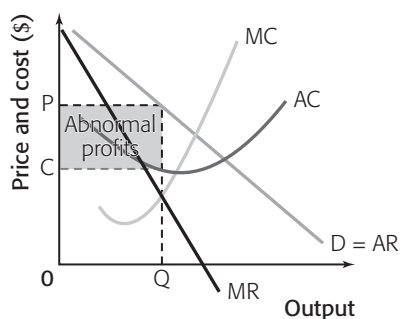
In monopolistic competition, in the long run firms make normal profits.

EFFICIENCY

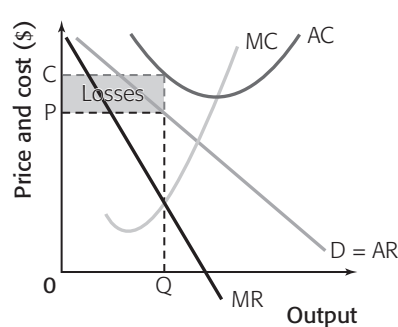
In the short run and the long run in monopolistic competition, firms are **neither** allocatively efficient, failing to produce where $MC = AR$, **nor** productively efficient, failing to produce where $MC = AC$.

Monopoly – assumptions

1. There is only one firm, so the firm is the industry.
2. Barriers to entry exist, which stops new firms entering the industry.
3. The monopolist may make abnormal profits in the long run because of barriers to entry.

SHORT-RUN ABNORMAL PROFITS

In monopoly, in the short run the firm may make excess profits. If this is the case, and the firm has barriers to entry, it will continue to do so in the long run.

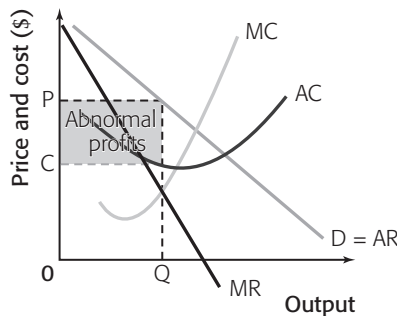
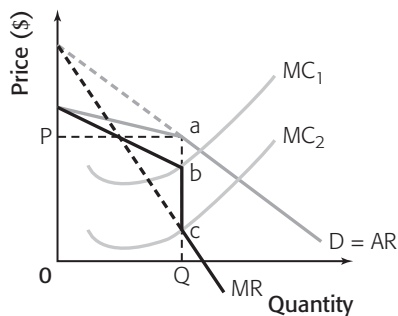
SHORT-RUN LOSSES

In monopoly, in the short run the firm may make losses. If this is the case, the firm will attempt to plan ahead in the long run to make at least abnormal profit. If it cannot, then it will shut down and the industry will disappear.

<p>SOURCES OF MONOPOLY POWER/BARRIERS TO ENTRY</p> <ol style="list-style-type: none"> 1. Economies of scale 2. Natural monopoly 3. Legal barriers 4. Brand loyalty 5. Anti-competitive behaviour 	<p>ADVANTAGES OF MONOPOLY OVER PC</p> <ul style="list-style-type: none"> • In monopoly, firms may achieve economies of scale and so have lower prices than in PC. • There may be higher levels of investment in R&D.
<p>EFFICIENCY</p> <p>In the short run and the long run in monopoly, the monopoly is neither allocatively efficient, failing to produce where $MC = AR$, nor productively efficient, failing to produce where $MC = AC$.</p>	<p>DISADVANTAGES OF MONOPOLY OVER PC</p> <ul style="list-style-type: none"> • Monopoly is productively and allocatively inefficient. • If economies of scale are not great enough, then the monopoly will restrict output and charge higher prices. • The monopoly may exercise anti-competitive behaviour.
<p>PRICE DISCRIMINATION</p> <p>This exists when a producer sells the exact same product to different consumers at different prices. There are three necessary conditions:</p> <ol style="list-style-type: none"> 1. The producer must have some price-setting ability, which is why it mostly occurs in oligopoly and monopoly. 2. The consumers must have different elasticities of demand. 3. The producer must be able to separate the different groups of consumers to avoid re-sale. 	

Oligopoly

1. Industry is dominated by a few firms, i.e. a large proportion of the industry's output is shared by just a small number of firms.
2. Some oligopolies have identical products, e.g. oil. Some have differentiated products, e.g. motor cars.
3. In most cases, there are barriers to entry, but not always.
4. Firms are very much influenced by the actions of other firms – **interdependence**.

<p>COLLUSIVE OLIGOPOLY</p>  <p>The graph shows Price and cost (\$) on the vertical axis and Output on the horizontal axis. It includes a downward-sloping Demand (D = AR) curve, a steeper downward-sloping Marginal Revenue (MR) curve, an upward-sloping Marginal Cost (MC) curve, and an upward-sloping Average Cost (AC) curve. The MC curve intersects the MR curve at quantity Q. A horizontal dashed line from Q on the x-axis meets the D curve at price P and the AC curve at price C. The rectangular area between P and C, from 0 to Q, is shaded and labeled 'Abnormal profits'.</p> <p>The firms collude to charge the same price, acting as a monopolist, and share the monopoly profits. Formal collusion is mostly illegal. However, tacit collusion – looking at your competitors' prices and charging the same – is not illegal. This is one reason why the prices in oligopoly tend to be rigid.</p>	<p>NON-COLLUSIVE OLIGOPOLY</p>  <p>The graph shows Price (\$) on the vertical axis and Quantity on the horizontal axis. It features a downward-sloping Demand (D = AR) curve and a steeper downward-sloping Marginal Revenue (MR) curve. There are two upward-sloping Marginal Cost curves, MC₁ and MC₂. Point 'a' is the intersection of MC₁ and MC₂. Point 'b' is the intersection of MC₁ and MR. Point 'c' is the intersection of MC₂ and MR. A horizontal dashed line from point 'b' meets the D curve at price P and the MC₂ curve at quantity Q. A vertical dashed line from point 'c' meets the x-axis at quantity Q. A dashed line from point 'a' is parallel to the MR curve. A kink is shown on the Demand curve at quantity Q and price P.</p> <p>Non-collusive oligopoly exists when the firms in an oligopoly do not collude and so have to be very aware of the reactions of other firms when making pricing decisions. One way of attempting to explain the situation in a non-collusive oligopoly is the kinked demand curve.</p>
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NON-PRICE COMPETITION

Since firms in oligopoly tend not to compete in terms of price, the concept of **non-price competition** becomes important. There are many kinds of non-price competition, e.g. the use of brand names, packaging, special features, advertising, sales promotion, personal selling, publicity, sponsorship deals and special distribution features, such as free delivery and after-sales service.

Oligopoly is characterized by very large advertising and marketing expenditures as firms try to develop brand loyalty and make demand for their products less elastic. Some may argue that this represents a misuse of scarce resources. It could also be argued that competition among the large companies results in greater choice for consumers.

There are three reasons why prices are rigid.

1. Firms are afraid to raise prices above the current market price, because other firms will not follow and so they will lose trade, sales, and probably profit.
2. Firms are afraid to lower their prices below the current market price, because other firms will follow, undercutting them, and so creating a **price war** that may harm all the firms involved.
3. The shape of the MR curve means that if marginal costs were to rise, then it is possible that MC would still equal MR and so the firms, being profit maximizers, would not change their prices or outputs. This can be seen in the diagram. If we assume that the firm is operating on MC₂, then it is maximizing profits by producing Q and selling at P. Marginal costs could rise as high as MC₁ and the firm would still be maximizing profits by producing at Q and charging P. Thus, the market remains stable, even though there have been significant price changes.